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Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554

In the Matter of	)	
	)	
Access Charge Reform	)	CC Docket No. 96-262
	)	
Price Cap Performance Review	)	CC Docket No. 94-1
for Local Exchange Carriers	)	
	)	
Transport Rate Structure	)	CC Docket No. 91-213
and Pricing	)	
	)	
Usage of the Public Switched	)	CC Docket No. 96-263
Network by Information Service	)	
and Internet Access Providers	)	
	)	

REPLY COMMENTS OF PUERTO RICO TELEPHONE COMPANY

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**SUMMARY**

Puerto Rico Telephone Company ("PRTC") has set forth two principles to which the Commission should adhere as it considers access charge reform for rate-of-return carriers, to a limited extent in this proceeding and ultimately in a separate proceeding: (1) access charge reform must not preclude recovery of investments by incumbent local exchange carriers ("ILECs") that were dictated by the existing regulatory regime, and (2) access charge reform must give ILECs pricing flexibility in offering access services so that they can compete with new entrants that will be less regulated.

Competition in providing access services means that carriers must be free to offer competitive prices for these services. Many parties agree that competition has arrived and will continue to grow, such that under any regulatory scheme adopted by the Commission, maximum freedom from rate-setting regulation is warranted.

However, this is a going-forward change that will not address the recovery of costs incurred by ILECs that have complied with all requirements imposed by existing regulations. To determine how to address this issue, the parties also must have an opportunity to gauge the effect of a revised universal service system on the continued ability to provide reliable basic telephone service. In addition, the shortfall in recovery caused by elongated depreciation schedules must be addressed.

Puerto Rico Telephone Company

February 14, 1997

Ultimately, the Commission may have to establish a regulatory fund to satisfy such cost recovery issues.

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**REPLY COMMENTS OF PUERTO RICO TELEPHONE COMPANY**

Puerto Rico Telephone Company ("PRTC"), by its attorneys, hereby submits reply comments in the above-captioned proceeding regarding reforms to the Commission's rules on access charges as presented in its recent Notice of Proposed Rulemaking.<sup>1</sup>

**I. INTRODUCTION**

Consistent with its comments in proceedings to implement local competition and universal service reform, PRTC urges the Commission to recognize that each of these proceedings is dramatically changing the regulations under which incumbent local exchange carriers ("ILECs") have been required to operate. With these changes, the Commission must address and resolve the concerns of ILECs that an effective means for cost recovery must

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<sup>1/</sup> In the Matter of Access Charge Reform, CC Docket No. 96-262, Notice of Proposed Rulemaking, FCC 96-488 (rel. December 24, 1996).

be established. The access charge proceeding appears to be the final proceeding in which to address meaningfully these concerns. PRTC is not alone in raising these issues. For example, Cincinnati Bell similarly has stated that "the Commission cannot usher in competition by requiring incumbent LECs to unbundle and resell their networks while at the same time cutting off one of the main sources of funds counted on by incumbent LECs to keep their networks operational. . . . In order for [ILECs] to meet these obligations/requirements without causing undue financial harm, [ILECs] must be permitted to recover [their] previously invested capital."<sup>2</sup>

PRTC's proposals in this proceeding are based on this same fact — that the company must recover those costs incurred as required by the regulatory regime of the past in order to continue as a viable service provider in the future. Moreover, the arrival of competition in the access services market means that ILECs must be permitted the flexibility to set prices that will enable them to compete for access customers.

## **II. COMPETITION FOR ACCESS SERVICES INDICATES THAT ACCESS REFORM MAY BE REQUIRED**

Carriers widely recognize that there are now competitive options for access service. The primarily unregulated offering of access service by competitive local exchange carriers

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<sup>2/</sup> Cincinnati Bell at 22.

("CLECs"), in addition to competitive access providers, makes regulatory reform a necessary precedent to the ILECs' ability to offer competitively priced access service.<sup>3</sup> The Independent Telephone and Telecommunications Alliance has aptly stated that "[r]egardless of whether Independent Telcos are regulated using price caps or rate of return, Independent Telcos are in need of the regulatory flexibility to compete in the newly competitive telecommunications services marketplace."<sup>4</sup>

A. Rate of Return Carriers Facing Competition Must Be Afforded Pricing Flexibility

Carriers similarly situated with PRTC — rate of return carriers facing competition — agree that ILECs must be able to meet the call of competition in order for access customers to have choices of access providers over the long-term. For example, Cincinnati Bell has urged the Commission not to delay access charge reform for non-price cap LECs, because some of them also "face the same immediate competitive pressures as the larger price cap LECs."<sup>5</sup> In addition, non-price cap LECs do not have

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<sup>3/</sup> See Ameritech at 29.

<sup>4/</sup> Independent Telephone and Telecommunications Alliance at 4.

<sup>5/</sup> Cincinnati Bell at 2; see also Roseville Telephone Company at 5-7 ("[Rate of return] carriers subject to competition without comprehensive access reform will be unfairly disadvantaged, and will be vulnerable to uneconomic bypass."); NECA at 9-10, 14 (advocating that rate of return carriers have the option of implementing access charge reforms until a proceeding specifically applicable to these carriers has been completed).

the same options for recouping revenues lost due to access charge reform, especially because their service tends to be limited to smaller geographic areas covering fewer metropolitan areas.<sup>6</sup>

ALLTEL, another rate of return carrier, has attested to its need for "the freedom to respond to competition in [its] denser markets."<sup>7</sup>

In fact, without such flexibility, the inability of an ILEC to retain and maintain a reasonable market share of its current service offering would adversely affect its operating capacity. In this regard, it would also impact the overall competitive environment, because the ILEC is expected to remain, for an undetermined number of years, the real owner and provider of an ubiquitous and reliable local telecommunications network.

B. Below-Cost Pricing Methodologies Should Not Be Applied in Access Charge Reform

CLECs will be able to gain a favorable competitive position if they purchase interconnection and unbundled network elements at prices below that of the ILECs' actual costs. Under these conditions, ILECs will not be able to compete for access customers with CLECs, who will remain largely unregulated. PRTC, consistent with similarly situated rate of return carriers facing

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<sup>6/</sup> Cincinnati Bell at 4 & n.6.

<sup>7/</sup> ALLTEL at 15.



competition, has advocated the ability to adjust rates in response to competition in this market.<sup>8</sup>

Centennial, a competitor of PRTC's and participant in this proceeding, appears to disagree with this position.<sup>9</sup> Centennial, which "is already actively competing with PRTC,"<sup>10</sup> has asserted that PRTC should be subject to access charge reform. Although providing only limited comments with regard to the Commission's NPRM regarding how rates will be adjusted, Centennial does suggest, however, that such rates should be transitioned to "truly cost-based access rates."<sup>11</sup> Therefore, it appears that Centennial advocates reform that would preclude by "regulatory fiat" to the extent necessary, PRTC's ability to compete in the access service market and recover actual costs.

Centennial has declared that PRTC has somehow taken advantage of the existing regulatory regime as "'cover' for its

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<sup>8/</sup> See PRTC at 6-8. See also ALLTEL at 7-8; Cincinnati Bell at 3-5; Roseville Telephone Company at 5-7; USTA at 10.

<sup>9/</sup> See generally Centennial Cellular Corporation. "Centennial" collectively refers to Centennial Cellular Corporation and its subsidiary Lambda Communications, Inc., a competitive local exchange carrier operating in Puerto Rico. Id. at 1.

<sup>10/</sup> Centennial at 4; see also id. at 7 (asserting that "it certainly makes no sense" to exempt PRTC from access charge reform because PRTC "already faces active competition from a CLEC").

<sup>11/</sup> Id. at 4.

efforts to thwart competition."<sup>12</sup> To address this perceived wrong, Centennial requests that the Commission impose "truly cost-based access rates" on PRTC and other rate of return carriers immediately. However, the effect of such a policy is not to prevent PRTC's alleged "anticompetitive regulatory and negotiating strategy" as charged by Centennial, but to cripple PRTC's future efforts to compete with carriers whose own access charge rates will be based on the purchase of LEC services at below cost rates. Rates set at TELRIC or TSLRIC reflect theoretical costs that can be lower than actual costs.<sup>13</sup> Centennial — PRTC's competitor, not an access customer — now requests that in revising the access charge regulatory regime, the Commission should specifically prevent PRTC from providing access service on a competitive basis by limiting its access prices and not allowing it to recover its actual incurred costs.

For truly competitive access services to emerge from this rulemaking, the Commission should consider offering ILECs pricing flexibility with regard to access charges in a competitive market. Otherwise, the competitive provider will simply engage in arbitrage between the artificially depressed price of

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<sup>12/</sup> Id. at 6.

<sup>13/</sup> To the extent that Centennial expresses in this proceeding complaints regarding PRTC's proposed rates for interconnection, these are appropriately addressed in the current arbitration proceeding before the Telecommunications Regulatory Board of Puerto Rico, initiated by Centennial on December 23, 1996 (Case No. 96-0002 AR).

interconnection and the price of access which currently fully recovers relevant costs.<sup>14</sup> This would result in just the type of uneconomic bypass that the Commission wishes to eliminate, not encourage, in this proceeding. Therefore, a balanced approach in this proceeding will permit all access providers to assess rates at a level determined by market forces and unrestrained by regulation, while also addressing those access rates that may not be in line with the manner in which costs are incurred.

**III. PROPER COST RECOVERY WILL BE ACHIEVED ONLY THROUGH AN ACCURATE ACCOUNTING OF USF SUPPORT PAYMENTS AND DEPRECIATION**

ILECs must be given the opportunity to deal with the loss of recovery they are facing once final regulations are determined with some specificity, for universal service and access charges. As PRTC has stated, the combined effect of these regulatory changes, including the way in which local competition provisions are being implemented, threatens a regulatory taking. Cincinnati Bell aptly has explained that certain investments have been made "to ensure the development of a ubiquitous Public Switched Telephone Network (PSTN). . . . An important point which new entrants want the Commission to ignore is that incumbent LEC revenue streams currently include payments to recover the embedded investments (plus a reasonable return), expenses, and

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<sup>14/</sup> See, e.g., GTE at 15 (finding that as compared to CLECs, "ILECs have virtually no flexibility to respond to new entrant pricing and service offerings").

taxes incurred in building the PSTN."<sup>15</sup> These issues can only be addressed with specificity once the actual universal service and access charge reforms are known. However, immediate steps can be taken to deal with the need for depreciation adjustments.

A. USF Payments That Do Not Replace Implicit Support from Access Charges Should Not Be Applied to Reduce Interstate Costs

As PRTC asserted in its Comments, the inability to assess the level of universal service support payments that will be available after the system is revised makes it difficult to predict the effect of such revisions on interstate costs for rate-of-return carriers.<sup>16</sup> Therefore, the Commission should not presume in this proceeding that such reductions will necessarily follow universal service reform. PRTC agrees with USTA that rate-of-return companies "should be permitted to use the funding from new universal service support mechanisms to offset existing explicit universal service requirements before reducing any other Part 69 rates. To the extent the new universal service fund revenues exceed existing explicit universal service requirements, Part 69 rate reductions should reduce implicit support amounts."<sup>17</sup>

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<sup>15/</sup> Cincinnati Bell at 24.

<sup>16/</sup> See also Evans Telephone, et al. at 3; Roseville Telephone Company at 16; Pacific Telesis at 49.

<sup>17/</sup> USTA at 69.

In addition, the method by which access rates are set in the future will have a direct impact on the ability of USF support to offset potential loss in cost recovery caused by access charge reform. For example, if TELRIC or TSLRIC is selected for determining access rates under a prescriptive methodology, revenues may be lost as compared to those generated by the current regulated rates.<sup>18</sup> As stated by US West, "in the real world, prices are never actually set at TELRIC because investment in new technology cannot be sustained if a TELRIC-based costing methodology were used to set price ceilings."<sup>19</sup>

B. The Commission Must Be Responsive to Carrier Requests for Revised Depreciation Schedules As Competition Develops

Some historical costs have been allocated to the interstate jurisdiction but not yet recovered due to extended depreciation schedules prescribed by the Commission. If access rates are adjusted under these circumstances, either under a market-based approach or a prescriptive approach, ILECs could lose this

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<sup>18/</sup> See NPRM at ¶ 248. In addition, the Commission has suggested that TELRIC studies may be used to derive the TSLRIC rates (¶ 225) and that TSLRIC or TELRIC in one study area may be appropriate to derive the same for another study area (¶ 226). As the Commission moves farther away from basing rates on actual costs with these proposals, it increases the probability that ILECs will be denied the opportunity to earn a return on past investments or be able to support future investments. See Group of State Advocates at 54 (finding that setting rates based on forward looking costs is appropriate, but not based on TSLRIC. TSLRIC excludes joint and common costs and will result in the shifting of those costs to other services).

<sup>19/</sup> US West at 3; see also PRTC at 4-5.

investment, not as a result of competition, but because of the artificially long economic life previously assigned by regulation. As explained by USTA:

Since increases in depreciation generally translated directly into price increases, there was a tendency by regulators to err on the side of under allocation. After all, pursuant to the regulatory contract, recovery would only be delayed by the use of low depreciation rates, not denied. Over the years, this tendency has resulted in a problem about which the Commission needs to take corrective action.<sup>20</sup>

Therefore, PRTC agrees with those parties who have explained that regulated depreciation rates have inhibited cost recovery.<sup>21</sup>

C. A Public Interest Fund May Be Necessary to Recover Regulated Loss of Cost Recovery

As PRTC stated in its Comments, in order to address these recovery issues, it may ultimately be necessary to consider establishing a regulatory fund dedicated to the recovery of these costs. This assessment can be better made once shortfalls can be quantified based both on the revised universal support system and access charge reform.<sup>22</sup>

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<sup>20/</sup> USTA at 72.

<sup>21/</sup> See Ameritech at 51 (finding that "the Commission's depreciation prescriptions have not reflected the economic realities of the changing marketplace and the technology demands of customers"); GTE at 39-40. But see AT&T at 32.

<sup>22/</sup> Cf. AT&T at 7 (suggesting that prices should be set now and that the determination of any difference between old and new revenues is "underrecovery," which could be conducted in a separate proceeding).

Pacific Telesis has made the compelling point that the downward pressure on access rates in the absence of a method for embedded cost recovery will have its greatest impact on other customers. Residential and small business subscribers may indeed be the last remaining markets for the recovery of embedded costs.<sup>23</sup> Such an outcome would be contrary to the intent of the 1996 Act and the public interest, unfair to these customers, and ultimately require ILECs to forego recovery of historic costs due to their inability to pass these costs through the appropriate cost-causers. Therefore, the Commission should adopt a cost recovery mechanism that both protects consumers from rate increases caused by access charge reform and preserves cost recovery so as to avoid an illegal taking.

**IV. ANY RESIDUAL COSTS THAT ARE NOT REALLOCATED FROM THE TIC MUST STILL BE RECOVERED FROM IXC's**

It is not surprising that the parties' position on this issue is generally split. Some parties deny that the TIC represents real transport costs. ILECs, on the other hand, seek to continue recovery of these costs from the parties that cause them.<sup>24</sup> PRTC agrees with USTA that "[t]he residual portion of

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<sup>23/</sup> Pacific Telesis at 48.

<sup>24/</sup> Roseville Telephone Company at 12-13 (asserting that "the TIC should not be phased out or eliminated unless and until the underlying ongoing real costs currently recovered by the TIC are allocated to other elements, or recovered by some other mechanism"); SNET at 39 ("ILECs should be provided the  
(continued...)

the TIC revenues represents real costs resulting from past separations decisions, as well as the interim local transport restructure. LECs must be allowed to continue to recover these costs in total."<sup>25</sup>

Other non-carrier parties support recovery of costs associated with the TIC. For example, the Group of State Consumer Advocates has concluded that the TIC should be recovered.

The remaining transport costs which are included in the TIC and cannot be identified with specific transport rate elements, represent a portion of the joint and common costs. They should properly be recovered from the transport rate elements. Therefore, these unassigned transport service category costs should be recovered by increasing all of the transport rate elements in some reasonable manner so that the transport rate elements in total cover the full transport costs. Any alternative that, in some manner, dumps costs that are properly associated with transport on some other services, is an undesirable result.<sup>26</sup>

Similarly, the Alabama PSC has stated that it "could support a plan . . . in which costs would be reassigned to transport facility elements based [on] cost studies to correct identifiable

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<sup>24/</sup> (...continued)

opportunity to recover of [sic] the TIC amount in full."); see also US West at 72; Ameritech at 21; Pacific Telesis at 72. But see Frontier at 9 (supporting phase-out of TIC that remains after identification and reallocation of assignable costs).

<sup>25/</sup> USTA at 66; see also Cincinnati Bell at 10-11 ("The costs assigned to the TIC are legitimate LEC costs which LECs must be allowed to fully recover. . . . The costs currently recovered through the TIC are the result of LECs applying Part 36 and Part 69 rules as directed by the Commission.").

<sup>26/</sup> Group of State Advocates at 36-37.



miscalculations. The costs associated with the remaining revenue shortfall, currently recovered through the TIC, should be shifted to a specifically identified separate fund or account to be recovered on a competitively-neutral basis . . . ."<sup>27</sup>

Any changes the Commission makes in this regard must be consistent with its representation to the Court of Appeals in the CompTel case that the TIC costs "are real costs that would not otherwise be recovered."<sup>28</sup> Therefore, the Commission must ensure that whether or not these costs are reassigned, they will still be recovered.

## V. CONCLUSION

For these reasons, the Commission should fashion access charge reform that affords cost recovery to incumbent local exchange carriers. In establishing these regulations, the Commission should ensure that carriers facing competition for access services have flexible pricing, so they can compete with

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<sup>27/</sup> Alabama PSC at 11. However, the Alabama PSC does support a phase-out of the TIC over some "reasonable" period of time.

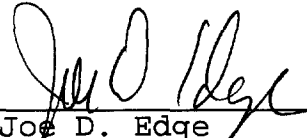
<sup>28/</sup> CompTel v. FCC, 87 F.3d 522, 530 (D.C. Cir. 1996).

Puerto Rico Telephone Company

February 14, 1997

those less-regulated carriers that are providing access service using the ILECs' own network.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Joe D. Edge", is written over a horizontal line.

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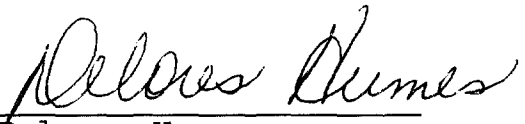
**CERTIFICATE OF SERVICE**

I, Delores Humes do hereby certify that a copy of the foregoing Reply Comments were hand delivered on this 14th day of February, 1997 to the following:

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